July 02, 2002

VALENCE TECHNOLOGY INC (VLNC)

Annual Report (SEC form 10-K)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

THIS REPORT CONTAINS STATEMENTS THAT CONSTITUTE "FORWARD-LOOKING STATEMENTS"

WITHIN THE MEANING OF SECTION 21E OF THE EXCHANGE ACT AND SECTION 27A OF THE SECURITIES ACT. THE WORDS "EXPECT", "ESTIMATE", "ANTICIPATE", "PREDICT", "BELIEVE" AND SIMILAR EXPRESSIONS AND VARIATIONS THEREOF ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS. SUCH STATEMENTS APPEAR IN A NUMBER OF PLACES IN THIS FILING AND INCLUDE STATEMENTS REGARDING THE INTENT, BELIEF OR CURRENT EXPECTATIONS OF VALENCE TECHNOLOGY, INC. (THE "COMPANY," "VALENCE," "WE," OR "US"), OUR DIRECTORS OR OFFICERS WITH RESPECT TO, AMONG OTHER THINGS

Exhibit B

(A) TRENDS AFFECTING OUR FINANCIAL CONDITION OR RESULTS OF OPERATIONS, (B) OUR PRODUCT DEVELOPMENT STRATEGIES, TRENDS AFFECTING OUR MANUFACTURING CAPABILITIES AND TRENDS AFFECTING THE COMMERCIAL ACCEPTABILITY OF OUR PRODUCTS, AND (C) OUR BUSINESS AND GROWTH STRATEGIES. OUR STOCKHOLDERS ARE CAUTIONED NOT TO PUT UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS. SUCH FORWARD-LOOKING STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND INVOLVE RISKS AND UNCERTAINTIES, AND ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE PROJECTED IN THIS REPORT, FOR THE REASONS, AMONG OTHERS, DISCUSSED IN THE SECTIONS -- "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS", AND "RISK FACTORS". THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND RELATED NOTES, WHICH ARE PART OF THIS REPORT OR INCORPORATED BY REFERENCE TO OUR REPORTS FILED WITH THE COMMISSION. WE UNDERTAKE NO OBLIGATION TO PUBLICLY REVISE THESE FORWARD-LOOKING STATEMENTS TO REFLECT EVENTS OR CIRCUMSTANCES THAT ARISE AFTER THE DATE HEREOF.

BUSINESS AND BUSINESS STRATEGY

Founded in 1989, our business has been driven primarily by our research and development efforts, which have fostered our intellectual property position, currently consisting of 818 issued and pending patents, including 268 patents issued in the United States. Since our inception, we have been focused on acquiring and developing our technology, developing our manufacturing capabilities, recruiting personnel, establishing our sales channels and pipeline and acquiring capital.

With the appointment of Stephan B. Godevais as our Chief Executive Officer and President in May 2001, we initiated the transition of our business by broadening our marketing and sales efforts to take advantage of our strengths in research and development. With this strategic shift, our vision is to become a leader in energy solutions by drawing on the numerous benefits of our latest battery technology, the extensive experience of our management team and the significant market opportunity available to us.

Our business strategy is to leverage our innovations in battery technology to capitalize on the significant opportunities in the energy solutions market. The strategy comprises the introduction of our "next generation" phosphate-based Saphion(TM) Lithium-ion technology; a balance of system sales and licensing; and a manufacturing plan that leverages

internal capabilities as well as OEM relationships. The strategy has been separated into three phases: technology phase, product phase and customer phase, incorporating key milestones in each.

We have introduced our phosphate-based, Saphion(TM) Lithium-ion technology and have transitioned production from research and development to our Northern Ireland manufacturing facility. We believe our Saphion(TM) technology addresses the major weaknesses of existing Lithium-ion alternatives while offering a solution that is competitive in cost and performance.

The system sales component of the strategy involves capitalizing on our advanced technology and understanding of certain market segments to design solutions that differentiate end customers' products and to develop new, emerging markets for our Saphion(TM) Lithium-ion technology solutions. Our systems sales strategy includes (i) continuing sales of our Cobalt and Manganese based stacked polymer batteries solutions to small to mid-sized companies where the flexibility of design and thinness of the stacked polymer is paramount, (ii) developing the market for Saphion(TM) technology through our own product launches, such As the N-Charge(TM) Power System, and products designed by others, such as the Wistron deal announced in February 2002 and (iii) maximizing the adoption of Saphion(TM) technology by offering it in both polymer and cylindrical constructions.

Our licensing strategy is to pursue technology licenses of intellectual property related to patent protected manufacturing processes and battery chemistries. Our stacked polymer battery manufacturing process and Saphion(TM) technology are our key assets in the licensing arena. In addition, we intend to partner with large material producers to leverage their manufacturing capabilities and existing sales channels. This should facilitate the rapid adoption of our Saphion(TM) technology and provide a source for licensing and royalty revenue.

Our manufacturing strategy involves both our own manufacturing capabilities in the Northern Ireland facility and OEM relationships. In May, 2002 we entered into an OEM agreement with Amperex Technology Limited, and intend to seek additional OEM partners for cylindrical cell construction and worldwide material production. We plan to enter into contracted manufacturing arrangements with cylindrical battery manufacturers. We believe this manufacturing strategy will allow us to deliver to a broad range of customer needs from low cost, high volume to highly customized, higher value added solutions.

We have outlined our business strategy in three phases as follows:

TECHNOLOGY PHASE: During this phase we evangelized the technology, completed our management team, announced the first major design win from a systems sales standpoint and signed an OEM agreement for the production of lithium-ion polymer batteries. This phase of our business transformation began in August 2001, and while ongoing, all but one, of our milestones have been met.

PRODUCT PHASE: During this phase we expect to complete the design of new products and continue the marketing to potential phosphate licensees, begin to launch phosphate products, announce key milestones around phosphate production and begin phosphate product ramps from both our Northern Ireland facility and OEM partners. This phase began in February 2002 with the launch of the N-Charge(TM) Power System. We are ramping up production of our phosphate batteries out of our Northern Ireland facility and are pursuing contract manufacturing arrangements with cylindrical battery manufacturers with the objective of using Saphion(TM) technology as a "drop in" lithium-ion chemistry replacement for notebook computers and communication devices.

CUSTOMER PHASE: During this phase, which will become our ongoing business, we expect to engage with customers regarding the launch of products using Saphion(TM) technology. On February 14, 2002 we announced the signing of a Memorandum of Understanding with Acer to work together to introduce the N-Charge(TM) Power System, which is powered by Saphion(TM) technology. On the same date, we announced the signing of a Memorandum of Understanding with Wistron to work together on a new mobile device that would include our Saphion

(TM) technology. On March 13, 2002, we announced that our N-Charge(TM) Power System will be featured in Hewlett-Packard's Education Solutions Portfolio product bundle for the K-12 education market. Subsequent to March 31, 2002, we began shipment of the N-Charge(TM) Power System to Hewlett Packard. We have engaged with several other Tier 1 OEMs regarding the N-Charge(TM) System and the use of our Saphion(TM) technology in other applications.

We have established a strategy that we believe will allow us to expand our market opportunity. Through the sale of our current technology and the licensing and market development of our Saphion(TM) technology, we believe we are equipped to serve existing Lithium-ion technology markets as well as open doors to new market opportunities.

RESULTS OF OPERATIONS

FISCAL YEARS ENDED MARCH 31, 2002 (FISCAL 2002), MARCH 31, 2001 (FISCAL 2001) AND MARCH 31, 2000 (FISCAL 2000)

REVENUE. The following table summarizes the Company's revenue by type for each of the past three fiscal years:

	MARCH 31, 2002	PERCENTAGE CHANGE	MARCH 31, 2001	PERCENTAGE CHANGE	MARCH 31, 2000
		A mounts in 000s			
Battery and laminate sales	$ 1,671	-77%	$7,191	374%	$ 1 ,518
License and royalty revenue	3,203	114%	1,500	N/A	-
Total revenues	$ 4,874	-44%	$8,691	473%	$ 1 ,518

BATTERY AND LAMINATE SALES: We completed our first commercial sale of batteries during February 2000. During fiscal 2001, we achieved an increase of 374% in revenue from sales of battery and laminate. In December 2000, we completed the acquisition of technology rights from Telcordia Technologies, Inc. and correspondingly completed a strategic shift away from expanding our battery and laminate sales pipeline to an emphasis on licensing and royalty revenue. During fiscal 2002, we implemented a balanced strategy leveraging revenues from both our licensing and battery and laminate lines of business. As a result of the strategic shifts, our revenue for battery and laminate sales decreased 77% to $1.7 million in fiscal 2002.

LICENSING AND ROYALTY REVENUE: In December 2000, we completed the acquisition of technology rights from Telcordia Technologies, Inc. We recorded initial revenues from licensing totaling $1.5 million during fiscal 2001. During fiscal 2002, we expanded our licensee base, including the conversion of a joint venture to a licensee, and began collecting royalties from our licensees resulting in a 114% increase in license and royalty revenue.

TOTAL REVENUES: Revenues from six significant customers represented a total of 83% of total revenues for the fiscal year and a total of 65% of the trade accounts receivable at March 31, 2002. For fiscal year 2001, five customers represented 98% of total revenues for the year and 95% of trade accounts receivable at March 31, 2001. In the fiscal year ended March 31, 2000, two customers had 98% of the total revenues for the year.

COST OF SALES. Cost of sales consists primarily of expenses incurred to manufacture battery and laminate products. We initiated the recording of costs of sales as we ramped production and began our transition from a research and development focused organization during fiscal 2001. During fiscal 2002, we recorded cost of sales of $8.6 million. Comparably, cost of sales totaled $18.2 million during fiscal 2001, net of grant funding of $1.2 million provided by the Northern Ireland Industrial Development Board, now known as Invest Northern Ireland or INI, as a reduction of labor

costs. The decrease from fiscal 2001 to fiscal 2002 represents over a 30% reduction of costs of sales as a percentage of sales. The substantial decrease in fiscal 2002 from fiscal 2001 is due to continued automation improvements in the Northern Ireland facility and the reduction in battery and laminate production volumes.

RESEARCH AND PRODUCT DEVELOPMENT. Research and product development expenses consist primarily of personnel, equipment and materials to support the Company's battery and product research and development. Research and product development expense totaled $9.7 million, $8.5 million, and $19.0 million for the fiscal years ended March 31, 2002, 2001, and 2000, respectively. The $1.2 million or 14% increase in research and product development expenses from fiscal 2001 to 2002 relates to the both additional engineering for development of the our first end-user product and expanded development and pilot production of our Saphion chemistry. The $10.5 million or 55% decrease in research and product development expenses from fiscal 2000 to 2001 reflects our initial transition from solely a research and development focus.

MARKETING. Marketing expenses consist primarily of costs related to sales and marketing personnel, public relations and promotional materials. Marketing expenses were $2.0 million, $1.1 million, and $0.3 million for the fiscal years ended March 31, 2002, 2001, and 2000, respectively. The $0.9 million or 81% increase in marketing expenses during fiscal 2002 resulted from increased personnel, the launch of a new corporate web site, the development of our on-line store, and the creation of promotional materials and sales tools. Our increased expenditures during fiscal 2002 and 2001 are in line with our transition from a research and development focused organization to a sales and customer focused entity.

GENERAL AND ADMINISTRATIVE. General and administrative expenses consist primarily of salaries and other related costs for finance, human resources, accounting, information technology, legal, and corporate related expenses. General and administrative expenses totaled $12.0 million, $11.7 million, and $6.8 million for the fiscal years ended March 31, 2002, 2001, and 2000 respectively. The $0.3 million or 3% increase in general and administrative expenses from fiscal 2001 to fiscal 2002 relate primarily to increased recruiting efforts associated with completion of the management team and relocation of the corporate office to Austin, Texas. The $4.9 million or 72% increase in general and administrative expenses from fiscal 2000 to fiscal 2001 was due to additional finance and management headcount, increased spending on investor relations, insurance, environmental compliance, and legal fees associated with intellectual property transactions.

DEPRECIATION AND AMORTIZATION. Depreciation and amortization expenses were $7.9 million, $11.3 million, and $9.5 million for fiscal years ended March 31, 2002, 2001, and 2000, respectively. The $3.4 million or 30% decrease in depreciation and amortization expenses during fiscal 2002 resulted primarily from the impact of an impairment charge taken during the third quarter of fiscal 2002 as described below. This decrease is partially offset by depreciation for capital assets acquired during fiscal 2002.

IMPAIRMENT CHARGE: During the third quarter of fiscal 2002, we recorded an impairment charge of $31.9 million. The charge was recorded pursuant to FASB Statement No. 121 "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of". During the third quarter of fiscal 2002, we refined our business strategy and solidified our manufacturing plan and product mix. As a result, we determined that the future cash flows expected to be generated from older manufacturing equipment in our Northern Ireland facility and intellectual property acquired in the Telcordia transaction in December 2000 did not exceed their carrying value. This determination resulted in a net impairment charge against property, plant and equipment and intellectual property to adjust these assets to their fair value.

FACTORY START-UP COSTS. During the fourth quarter of fiscal 2000, the Company started shipping commercial quality grade batteries under an existing purchase order. The cost of raw materials used to bring the machinery up to production quality, along with related consumables and direct labor, were separated as factory start-up costs in the amount of $3.2 million.

STOCKHOLDER LAWSUIT SETTLEMENT. As announced on February 10, 2000, we reached a settlement in the securities class-action lawsuit that had been pending against the Company. The court-approved settlement dismissed all claims against us and all other defendants without presumption or admission of any liability or wrong-doing. Under the terms of the settlement, a payment of $1.3 million in cash was made, and we issued 950,000 shares of common stock, to the class fund. We took an accounting charge during the fourth quarter of fiscal 2000 of $30.1 million or ($0.98) per share for the impact of this settlement.

INTEREST AND OTHER INCOME. Interest and other income increased 63% to $2.0 million for the fiscal year ended March 31, 2001 from $1.3 million for the fiscal year ended March 31, 2001. Interest and other income increased 56% to $1.3 million for the fiscal year ended March 31, 2001, from $804,000 for the fiscal year ended March 31, 2000. The increases in both fiscal 2002 and 2001 were due primarily to increased investment income.

INTEREST EXPENSE. Interest expense increased 86% to $4.3 million for the fiscal year ended March 31, 2002 from $2.3 million for the fiscal year ended March 31, 2001. Interest expense increased 27% to $2.3 million for the fiscal year ended March 31, 2001, from $1.8 million for the fiscal year ended March 31, 2000. The increases for both fiscal 2002 and in 2001 were the result of increased borrowings from Berg & Berg.

EQUITY IN EARNINGS (LOSS) OF JOINT VENTURE. In June 2001, we reached and agreement with our joint venture partner, Hanil Telecom Co., Ltd. (Hanil Telecom) to terminate the Hanil Valence Korean joint venture. As conditions of the termination, Shinhan Bank transferred its payment guarantee obligations under a line of credit from us to Hanil Telecom and we granted a license to an affiliate of Hanil Telecom. In addition, the deferred revenue balance of $2.5 million was offset by approximately $896,000 of accounts receivable and the remaining $1.6 million balance was recorded as license revenue to recognize the license agreement.

LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2002, we had cash and cash equivalents of $623,000. On April 9, 2002 we raised net proceeds of approximately $15.2 million through the sale of 6.122 million shares of our common stock. In addition, as of March 31,

2002 we had $3.5 million available under a loan agreement and $30.0 million available under an equity line of credit with Berg & Berg Enterprises. This equity line of credit is subject to stockholder approval at our 2002 annual meeting and completion of definitive documentation. We have commitments for capital expenditures for the next 12 months of approximately $1.2 million relating to specified manufacturing equipment, which is included in accrued expenses at March 31, 2002. We may require additional capital expenditures in order to meet greater demand levels for our products than are currently anticipated. After taking into account our cash and cash equivalents, projected cash flows from licensing and systems sales and available funding from our loan agreement and equity line of credit, we expect that we will have sufficient financing through fiscal 2003 to meet our working capital, capital expenditure and investment requirements. At our current level of operations, we are using cash from operations of approximately $6.0 to $9.0 million per quarter. We expect our cash requirements to increase as our sales increase, and we intend to manage our capital expenditures based on our then available sources of cash. We may have additional sources of cash from the commercialization of our Saphion(TM) technology into new markets and customers in addition to the sale of new products announced in February 2002. However, at this time we are not able to accurately forecast cash from these sources.

We used net cash from operations for fiscal 2002, 2001 and 2000 of $26.2 million, $38.2 million and $29.8 milli n, respectively. The cash used in our fiscal 2002 operating activities was primarily due to net loss and the add back of non-cash expenses, including depreciation and amortization, provision for bad debt, impairment charge, accretion of debt discount, and compensation related to issuance of stock options. The decrease in operating cash outflows was substantially due to operational improvements, lower production levels and inventory utilization in our Northern

Ireland facility.

We used $8.8 million, $21.8 million and $5.2 million in investing activities in fiscal 2002, 2001 and 2000, respectively. Capital expenditures during fiscal 2001and fiscal 2002 were primarily related to the establishment and expansion of our manufacturing facilities and equipment in our Dutch subsidiary.

We obtained cash from financing activities of $32.4 million, $40.8 million and $57.2 million in fiscal 2002, 2001 and 2000, respectively.

As a result of the above, we had a net decrease in cash and cash equivalents of $3.1 million and $20.8 million in fiscal 2002 and 2001; and a net increase in cash and cash equivalents of $22.1 million in fiscal 2000.

As of March 31, 2002, our short term and long-term debt obligations were $683,000 and $34.6 million respectively. During fiscal 2002, we reached an agreement with Mr. Berg to extend the maturity date of our loan agreement with the loan balance of $14.95 million and accrued interest of $3.4 million from August 30, 2002 to September 30, 2005.

During fiscal year 1994, we, through our Dutch subsidiary, signed an agreement with the INI to open an automated manufacturing plant in Northern Ireland in exchange for capital and revenue grants from the INI. The grants available under the agreement and offers for an aggregate of up to (pound)25.6 million, generally became available over a five-year period through October 31, 2001. As a condition to receiving funding from INI, the subsidiary must maintain a minimum of (pound)12.0 million (approximately $16.9 million) in debt or equity financing from the Company. As of March 31, 2002, we had received grants aggregating (pound)9.4 million ($13.4 million). The amount of the grants available under the agreement and offers depends primarily on the level of capital expenditures that are made by the Company. Substantially all of the funding received under the grants is repayable to the INI if the subsidiary is in default under the agreement and offers, which includes the permanent cessation of business in Northern Ireland. Funding received under the grants to offset capital expenditures is repayable if related equipment is sold, transferred or otherwise disposed of during a four-year period after the date of grant. In addition, a portion of funding received under the grants may also be repayable if the subsidiary fails to maintain specified employment levels for the two-year period immediately after the end of the five-year grant period. As a result of the temporary reduction of Northern Ireland business activity, specified employment levels have not been maintained, but the INI is not seeking repayment and on the advice of counsel, on the basis that successful negotiations will be concluded, we do not believe that the INI will bring any legal action pursuant to the Letter of Offer. We have begun discussion with the INI to end the current agreement and enter into a new agreement more closely aligned to current business conditions. We may not be able to meet the requirements necessary to retain grants under the INI agreement. Although it is unlikely, the INI could demand repayment of a portion of the total amounts received, which include revenue grants of $1.2 million and equipment grants of $12.2 million.

Since inception, we have experienced significant losses and negative cash flow from operations. We believe that our existing cash and cash equivalents, anticipated cash flows from our operating activities and available financing will be sufficient to fund our working capital and capital expenditure needs through fiscal 2003. If our working capital requirements and capital

expenditures are greater than we expect, we may need to raise additional debt or equity financing in order to provide for our operations. There can be no assurance that additional debt or equity financing will be available on acceptable terms or at all.

RECENT EVENTS

Pursuant to a Letter Agreement and Release effective March 31, 2002, we disposed of certain assets consisting of cash

and investment equivalent instruments valued at approximately $18.6 million in exchange for a discharge and release of all obligations under our loan agreement with Berg & Berg Enterprises, LLC dated February 24, 2002. That loan agreement had an outstanding balance in the principal amount of $17,500,000 and accrued and unpaid interest of $1,140,370.41 at March 31, 2002.

INFLATION

Historically, our operations have not been materially affected by inflation. However, our operations may be affected by inflation in the future.

RISK FA CTORS

CAUTIONARY STATEMENT S AND RISK FACTORS

SEVERAL OF THE MATTERS DISCUSSED IN THIS REPORT CONTAIN FORWARD-LOOKING STATEMENTS THAT INVOLVE RISKS AND UNCERTAINTIES. FACTORS ASSOCIATED WITH THE FORWARD-LOOKING STATEMENTS THAT COULD CAUSE ACTUAL RESULTS TO DIFFER FROM THOSE PROJECTED OR FORECASTED IN THIS REPORT ARE INCLUDED IN THE STATEMENTS BELOW. IN ADDITION TO OTHER INFORMATION CONTAINED IN THIS REPORT, YOU SHOULD CAREFULLY CONSIDER THE FOLLOWING CAUTIONARY STATEMENTS AND RISK FACTORS.

RISKS RELATED T O OUR BUSINESS

WE MAY HAVE A NEED FOR ADDITIONAL FINANCING.

We may need to raise additional capital. If we cannot obtain additional financing on reasonable terms, or at all, we may not be able to execute our business strategy as planned and our results of operations would suffer. At March 31, 2002, we had cash and cash equivalents of $623,000. On April 9, 2002 we raised net proceeds of approximately $15.2 million through the sale of 6.122 million shares of our common stock. In addition, at March 31, 2002 we had $3.5 million available under a loan agreement and $30.0 million available under an equity line of credit with Berg & Berg Enterprises.

Our financing commitment with Berg & Berg will enable us to access up to $5.0 million per quarter (but no more than $30.0 million in the aggregate) in equity capital over the next two years. This commitment is subject to stockholder approval at our 2002 annual meeting and completion of definitive documentation. In exchange for any amounts funded pursuant to this new agreement, we will issue to Berg & Berg restricted common stock at a customary discount to market. We will agree to register any shares we issue to Berg & Berg under this agreement. Berg & Berg's obligation to fund the equity commitment is subject to conditions including, but not limited to, our achievement of operating milestones. In addition, Berg & Berg has the option to reduce the commitment to the extent we enter into a debt or equity financing arrangement with a third party at any time during the term of the commitment. As a result of the offering we completed in April 2002, Berg & Berg may elect to reduce its commitment to $13,470,600.

At our current level of operations, we are using cash from operations of approximately $6.0 to $9.0 million per quarter. To sustain our operations for a longer period of time than can be funded from operations and our commitments from Berg & Berg, we may need to seek additional financing. Our cash requirements may vary materially from those now planned because of changes in our operations, including changes in OEM relationships, market conditions, joint venture and business opportunities, or a request for repayment of a portion or all of our existing grants, which totaled $13.4 million at March 31, 2002, from the Northern Ireland Industrial Development Board.

ALL OF OUR ASSETS ARE PLEDGED AS COLLATERAL UNDER OUR LOAN AGREEMENTS. OUR FAILURE TO MEET THE OBLIGATIONS UNDER OUR LOAN AGREEMENTS COULD RESULT IN FORECLOSURE OF OUR ASSETS.

All of our assets are pledged as collateral under various loan agreements. If we fail to meet our obligations pursuant to these loan agreements, our lenders may declare all amounts borrowed from them to be due and payable together with accrued and unpaid interest. If we are unable to repay our debt, these lenders could proceed against our assets.

WE HAVE A HISTORY OF LOSSES, HAVE AN ACCUMULATED DEFICIT AND MAY NEVER ACHIEVE OR SUSTAIN SIGNIFICANT REVENUES OR PROFITABILITY.

We have incurred operating losses each year since inception in 1989 and had an accumulated deficit of $336.7 million as of March 31, 2002. We have negative working capital of $2.9 million as of March 31, 2002, and have sustained recurring losses related primarily to the research and development and marketing of our products. We expect to continue to incur operating losses and negative cash flows through fiscal 2003, as we begin to build inventory, increase our marketing efforts and continue our product development. We may never achieve or sustain significant revenues or profitability in the future.

OUR BUSINESS MAY BE ADVERSELY AFFECTED IF OUR SAPHION(TM) TECHNOLOGY BATTERIES ARE NOT COMMERCIALLY ACCEPTED.

We are researching and developing batteries based upon phosphate chemistry. Our batteries are designed and manufactured as components for other companies and end-user customers. Our success is dependent on the acceptance of our batteries and the products using our batteries in their markets. Market acceptance may depend on a variety of factors, including educating the target market regarding the benefits of our products. Market acceptance and market share are also affected by the timing of market introduction of competitive products. If we or our customers are unable to gain any significant market acceptance for Saphion(TM) technology based batteries, our business will be adversely affected. It is too early to determine if Saphion(TM) technology based batteries will achieve significant market acceptance.

IF WE ARE UNABLE TO DEVELOP, MANUFACTURE AND MARKET PRODUCTS THAT GAIN WIDE CUSTOMER ACCEPTANCE, OUR BUSINESS MAY BE ADVERSELY AFFECTED.

The process of developing our products is complex and uncertain, and failure to anticipate customers' changing needs and to develop products that receive widespread customer acceptance could significantly harm our results of operations. We must make long-term investments and commit significant resources before knowing whether our predictions will eventually result in products that the market will accept. After a product is developed, we must be able to manufacture sufficient volumes quickly and at low costs. To accomplish this, we must accurately forecast volumes, mix of products and configurations that meet customer requirements, and we may not succeed.

FAILURE TO DEVELOP SALES CHANNELS FOR OUR CURRENT AND FUTURE END-USER PRODUCTS

WOULD SIGNIFICANTLY IMPACT OUR FUTURE REVENUE AND PROFITABILITY.

We introduced the N-Charge(TM) Power System, our first end-user product in February 2002. We must develop reliable sales channels for distribution of our N-Charge(TM) product and any future end-user products. If our N-Charge (TM) product is not commercially accepted, our results of operations will be adversely affected. In addition, failure to develop effective sales channels will significantly impact our future revenue and profitability.

OUR FAILURE TO DEVELOP PARTNERSHIPS WITH OTHER BATTERY MANUFACTURERS WILL LIMIT

OUR ABILITY TO WIDELY INTRODUCE OUR PHOSPHATE CHEMISTRY TECHNOLOGY INTO THE

MARKETPLACE AND COULD SIGNIFICANTLY IMPACT OUR SALES AND PROFITABILITY IN FUTURE

PERIODS.

To successfully implement our business strategy of broadly disseminating the Saphion(TM) technology, we intend to develop relationships with manufacturers of lithium-ion batteries using stacked polymer technology as well as cylindrical battery manufacturers. Our failure to develop these relationships will limit our ability to widely introduce our phosphate chemistry technology into the marketplace and could significantly impact our sales and profitability in future periods.

WE RECENTLY FORMED RELATIONSHIPS WITH THREE OF THE WORLD'S LEADING PERSONAL

COMPUTER VENDORS. THESE RELATIONSHIPS MAY NOT RESULT IN SALES OR PROFITABILITY.

We recently entered into a Memorandum of Understanding with each of Acer and Wistron for the development of devices using our technology. Additionally, we have entered into a relationship with Hewlett-Packard in which our N-Charge(TM) product will be featured in Hewlett-Packard's Education Solutions Portfolio product bundle. Subsequently, Hewlett Packard placed an initial purchase order and we began shipment of the N-Charge(TM) product in April, 2002. Neither the Memoranda of Understanding with Acer or Wistron nor the relationship with Hewlett-Packard requires the companies to make any financial commitments to us and may not lead to additional purchase orders. As a result, these relationships may not result in significant sales of products incorporating our Saphion(TM) technology, including sales of our N-Charge(TM) product. If these relationships result in additional sales, we cannot assure you that they will be profitable. If these relationships do not lead to significant purchase orders, our future revenues and profitability may be materially adversely affected.

BECAUSE OUR BATTERIES ARE INTENDED PRIMARILY TO BE INCORPORATED INTO OTHER PRODUCTS, WE WILL NEED TO RELY ON ORIGINAL EQUIPMENT MANUFACTURERS TO COMMERCIALIZE OUR PRODUCTS. WE MAY NOT OBTAIN ADEQUATE ASSISTANCE FROM THESE THIRD PARTIES TO SUCCESSFULLY COMMERCIALIZE OUR PRODUCTS.

Our business strategy contemplates that we will be required to rely heavily on assistance from original equipment manufacturers to gain market acceptance for our products. We therefore will need to identify acceptable original equipment manufacturers and enter into agreements with them. Once we identify acceptable original equipment manufacturers and enter into agreements with them, we will need to meet these companies' requirements by developing and introducing new products and enhanced, or modified, versions of our existing products on a timely basis. Original equipment manufacturers often require unique configurations or custom designs for batteries, which must be developed and integrated into their product well before the product is launched. This development process not only requires substantial lead-time between the commencement of design efforts for a customized battery system and the commencement of volume shipments of the battery system to the customer, but also requires the cooperation and assistance of the original equipment manufacturers for purposes of determining the battery requirements for each specific application. If we are unable to design, develop and introduce products that meet original equipment manufacturers' requirements, we may lose opportunities to enter into additional purchase orders and our reputation may be damaged. As a result, we may not receive adequate assistance from original equipment manufacturers or battery pack assemblers to successfully commercialize our products, which could impair our profitability.

FAILURE TO IMPLEMENT AN EFFECTIVE LICENSING BUSINESS STRATEGY COULD ADVERSELY AFFECT OUR REVENUE, CASH FLOW AND PROFITABILITY.

In December 2000, we acquired the intellectual property assets of Telcordia Technologies, Inc. As a result of the acquisition of these intellectual property assets and the internal development of our Saphion(TM) technology, we significantly increased the role of licensing in our business strategy. We have not entered into any licensing agreements for our Saphion(TM) technology. Our future operating results could be affected by a variety of factors including:

o our ability to secure and maintain significant customers of our proprietary technology;

o the extent to which our future licensees successfully incorporate our technology into their products;

o the acceptance of new or enhanced versions of our technology;

o the rate that our licensees manufacture and distribute their products to OEMs;

o our ability to secure one-time license fees and ongoing royalties for our technology from licensees.

Our future success will also depend on our ability to execute our licensing operations simultaneously with our other business activities. If we fail to substantially expand our licensing activities while maintaining our other business activities, our results of operations and financial condition will be adversely affected.

FAILURE TO OBTAIN INTERNATIONAL REGULATORY APPROVAL FOR COMMERCIAL SHIPMENTS OF

PHOSPHATE MATERIAL WOULD CAUSE DELAYS IN THE PRODUCTION RAMP PLAN FOR OUR

BATTERY TECHNOLOGY AND RESULT IN DELAYS OR LOSSES OF REVENUES ASSOCIATED WITH

THAT PLAN.

We currently are shipping phosphate material from our facility in Henderson, Nevada to our manufacturing facility in Mallusk, Northern Ireland as research and development material. We must receive regulatory approval from the appropriate international regulatory entities to ship commercial quantities of the material. Failure to obtain the appropriate regulatory approvals internationally would cause delays in the production ramp plan for our battery technology and result in delays or losses of revenue associated with that plan.

OUR FAILURE TO COST-EFFECTIVELY MANUFACTURE BATTERIES IN COMMERCIAL QUANTITIES,

WHICH SATISFY OUR CUSTOMERS' PRODUCT SPECIFICATIONS, COULD DAMAGE OUR CUSTOMER

RELATIONSHIPS AND RESULT IN SIGNIFICANT LOST BUSINESS OPPORTUNITIES FOR US.

To be successful, we must cost-effectively manufacture commercial quantities of our batteries that meet customer specifications. To facilitate commercialization of our products, we will need to reduce our manufacturing costs, which includes substantially raising and maintaining battery yields of commercial quality in a cost-effective manner. If we fail to substantially increase yields in our manufacturing process and reduce unit-manufacturing costs, we will not be able to offer our batteries at a competitive price, and we will lose our current customers and fail to attract future customers.

FAILURE TO SCALE UP OUR MANUFACTURING FACILITY WILL HARM OUR CUSTOMER RELATIONS

AND THREATEN FUTURE PROFITS.

We have begun to manufacture batteries on a commercial scale to fulfill purchase orders and we are able to produce sufficient quantities of batteries for short term needs. We continue to install, de-bug and qualify equipment in our manufacturing facility. If we fail to develop and efficiently operate a large scale manufacturing facility capable of cost-effectively producing significant quantities of batteries according to customer specifications, our ability to serve the needs of our customers will be harmed and our future sales and profits will be threatened.

OUR PATENT APPLICATIONS MAY NOT RESULT IN ISSUED PATENTS.

Patent applications in the United States are maintained in secrecy until the patents issue or are published. Since publication of discoveries in the scientific or patent literature tends to lag behind actual discoveries by several months, we cannot be certain that we were the first creator of inventions covered by pending patent applications or the first to file patent applications on such inventions. We also can not be certain that our pending patent applications will result in issued patents or that any of our issued patents will afford protection against a competitor. In addition, patent

applications filed in foreign countries are subject to laws, rules and procedures which differ from those of the United States, and thus we cannot be certain that foreign patent applications related to issued United States patents will issue. Furthermore, if these patent applications issue, some foreign countries provide significantly less effective patent enforcement than the United States.

The status of patents involves complex legal and factual questions and the breadth of claims allowed is uncertain. Accordingly, we cannot be certain that patent applications we file will result in patents being issued, or that our patents and any patents that may be issued to us in the future will afford protection against competitors with similar technology. In addition, patents issued to us may be infringed upon or designed around by others and others may obtain patents that we need to license or design around, either of which would increase costs and may adversely affect our operations.

IF WE CANNOT PROTECT OR ENFORCE OUR EXISTING INTELLECTUAL PROPERTY RIGHTS OR IF

OUR PENDING PATENT APPLICATIONS DO NOT RESULT IN ISSUED PATENTS, WE MAY LOSE THE

ADVANTAGES OF OUR RESEARCH AND MANUFACTURING SYSTEMS.

Our ability to compete successfully will depend on whether we can protect our existing proprietary technology and manufacturing processes. We rely on a combination of patent and trade secret protection, non-disclosure agreements and cross-licensing agreements. These measures may not be adequate to safeguard the proprietary technology underlying our batteries. Employees, consultants, and others who participate in the development of our products may breach their non-disclosure agreements with us, and we may not have adequate remedies in the event of their breaches. In addition, our competitors may be able to develop products that are equal or superior to our

products without infringing on any of our intellectual property rights. Moreover, we may not be able to effectively protect our intellectual property rights outside of the United States.

We have established a program for intellectual property documentation and protection in order to safeguard our technology base. We intend to vigorously pursue enforcement and defense of our patents and our other proprietary rights. We could incur significant expenses in preserving our proprietary rights, and these costs could harm our financial condition. We also are attempting to expand our intellectual property rights through our applications for new patents. We cannot be certain that our pending patent applications will result in issued patents or that our issued patents will afford us protection against a competitor. Our inability to protect our existing proprietary technologies or to develop new proprietary technologies may substantially impair our financial condition and results of operations.

INTELLECTUAL PROPERTY INFRINGEMENT CLAIMS BROUGHT AGAINST US COULD BE TIME

CONSUMING AND EXPENSIVE TO DEFEND, AND IF ANY OF OUR PRODUCTS OR PROCESSES ARE

FOUND TO BE INFRINGING, WE MAY NOT BE ABLE TO PROCURE LICENSES TO USE PATENTS

NECESSARY TO OUR BUSINESS AT REASONABLE TERMS, IF AT ALL.

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. While we currently are not engaged in any intellectual property litigation or proceedings, we may

become involved in these proceedings in the future. In the future we may be subject to claims or inquiries regarding our alleged unauthorized use of a third party's intellectual property. An adverse outcome in litigation could force us to do one or more of the following:

o stop selling, incorporating or using our products that use the challenged intellectual property;

o pay significant damages to third parties;

o obtain from the owners of the infringed intellectual property right a license to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or

o redesign those products or manufacturing processes that use the infringed technology, which may be economically or technologically infeasible.

Whether or not an intellectual property litigation claim is valid, the cost of responding to it, in terms of legal fees and expenses and the diversion of management resources, could be expensive and harm our business.

OUR ABILITY TO MANUFACTURE LARGE VOLUMES OF BATTERIES IS LIMITED AND MAY PREVENT

US FROM FULFILLING ORDERS.

We are actively soliciting additional purchase orders. We are qualifying additional automated equipment at our facility in Mallusk, Northern Ireland which will provide us with sufficient capacity to assemble batteries in high volumes. We expect this equipment to be fully operational during the second quarter of fiscal 2003. If we cannot rapidly increase our production capabilities to make sufficient quantities of commercially acceptable batteries, we may not be able to fulfill purchase orders in a timely manner, if at all. In addition, we may not be able to procure additional purchase orders, which could cause us to lose existing and future customers, purchase orders, revenue and profits.

IF OUR BATTERIES FAIL TO PERFORM AS EXPECTED, WE COULD LOSE EXISTING AND FUTURE

BUSINESS, AND OUR LONG-TERM ABILITY TO MARKET AND SELL OUR BATTERIES COULD BE

HARMED.

If we manufacture our batteries in commercial quantities and they fail to perform as expected, our reputation could be severely damaged, and we could lose existing or potential future business. Even if the performance failure is corrected, this performance failure might have the long-term effect of harming our ability to market and sell our batteries.

WE DEPEND ON A SMALL NUMBER OF CUSTOMERS FOR OUR REVENUES, AND OUR RESULTS OF

OPERATIONS AND FINANCIAL CONDITION COULD BE HARMED IF WE WERE TO LOSE THE

BUSINESS OF ANY ONE OF THEM.

To date, our existing purchase orders in commercial quantities are from a limited number of customers. We anticipate that sales of our products to a limited number of key customers will continue to account for a significant portion of our

total revenues. We do not have long-term agreements with any of our customers and do not expect to enter into any long-term agreements in the near future. As a result, we face the substantial risk that any of the following events could occur:

o reduction, delay or cancellation of orders from a customer;

o development by a customer of other sources of supply;

o selection by a customer of devices manufactured by one of our competitors for inclusion in future product generations;

o loss of a customer or a disruption in our sales and distribution channels; and

o failure of a customer to make timely payment of our invoices.

If we were to lose one or more customers, or if we were to lose revenues due to a customer's inability or refusal to continue to purchase our batteries, our business, results of operations and financial condition could be harmed.

THE FACT THAT WE DEPEND ON A SOLE SOURCE SUPPLIER OR A LIMITED NUMBER OF SUPPLIERS FOR KEY RAW MATERIALS MIGHT DELAY OUR PRODUCTION OF BATTERIES.

We depend on a sole source supplier or a limited number of suppliers for certain key raw materials used in manufacturing and developing our batteries. We generally purchase raw materials pursuant to purchase orders placed from time to time and have no long-term contracts or other guaranteed supply arrangements with our sole or limited source suppliers. As a result, our suppliers may not be able to meet our requirements relative to specifications and volumes for key raw materials, and we may not be able to locate alternative sources of supply at an acceptable cost. We have in the past experienced delays in product development due to the delivery of nonconforming raw materials from our suppliers, and if in the future we are unable to obtain high quality raw materials in sufficient quantities on competitive pricing terms and on a timely basis, it may delay battery production, impede our ability to fulfill existing or future purchase orders and harm our reputation and profitability.

WE HAVE FOUR KEY EXECUTIVES. THE LOSS OF A SINGLE EXECUTIVE OR THE FAILURE TO HIRE AND INTEGRATE CAPABLE NEW EXECUTIVES COULD HARM OUR BUSINESS.

Other than our written employment agreement with Stephan B. Godevais, our President and Chief Executive Officer, we do not have written employment contracts and do not have key man life insurance policies with respect to any of our key members of management. Without qualified executives, we face the risk that we will not be able to effectively run our business on a day-to-day basis or execute our long-term business plan.

OUR REVENUE FROM LICENSE FEES AND ROYALTIES WILL DEPEND SIGNIFICANTLY ON THE SUCCESS OF OUR LICENSEES AND THE MARKET DEMAND FOR THEIR PRODUCTS.

We expect to generate income from license fees as well as ongoing royalties based on sales by licensees that design, manufacture and sell batteries incorporating our technology. License fees will be nonrefundable and may be paid in one

or more installments. Ongoing royalties will be nonrefundable and generally based on a percentage of the selling price of the batteries that incorporate our technology sold by the licensee. Because we expect to derive a portion of our future revenues from royalties on shipments by our licensees, our future success depends upon the ability of our licensees to develop and introduce high volume batteries that achieve and sustain market acceptance. If our licensees are not successful or the demand for lithium-ion polymer batteries, Saphion(TM) technology batteries or devices utilizing these batteries does not increase, our revenues and profitability will be adversely affected. In addition, our license fee revenues depend on our ability to gain additional licensees within existing and new markets.

A reduction in the demand for lithium-ion polymer batteries, Saphion(TM) technology batteries, our loss of key existing licensees or our failure to gain additional licensees could have a material adverse effect on our business.

THERE IS A POTENTIAL SALES-CHANNEL CONFLICT BETWEEN OUR FUTURE TECHNOLOGY LICENSEES AND US.

The acquisition of the Telcordia intellectual property assets and our Saphion(TM) technology licensing strategy has added significant diversity to our overall business structure and our opportunities. We recognize that there is potential for a conflict among our sales channels and those of our future technology licensees. Although our manufacturing and marketing business generally is complimentary to our licensing business, sales-channel conflicts may arise. If these potential conflicts do materialize, we may not be able to mitigate the effect of a conflict that, if not resolved, may impact our results of operations.

OUR OXIDE-BASED BATTERIES, WHICH NOW COMPRISE A SMALL PORTION OF OUR AVAILABLE PRODUCTS, CONTAIN POTENTIALLY DANGEROUS MATERIALS, WHICH COULD EXPOSE US TO PRODUCT LIABILITY CLAIMS.

In the event of a short circuit or other physical damage to an oxide based battery, a reaction may result with excess heat or a gas being generated and released. If the heat or gas is not properly released, the battery may be flammable or potentially explosive. We could, therefore, be exposed to possible product liability litigation. In addition, our batteries incorporate potentially dangerous materials, including lithium. It is possible that these materials may require special handling or that safety problems may develop in the future. We are aware that if the amounts of active materials in our batteries are not properly balanced and if the charge/discharge system is not properly managed, a dangerous situation may result. Battery pack assemblers using batteries incorporating technology similar to ours include special safety circuitry within the battery to prevent such a dangerous condition. We expect that our customers will have to use a similar type of circuitry in connection with their use of our oxide-based products.

ACCIDENTS AT OUR FACILITIES COULD DELAY PRODUCTION AND ADVERSELY AFFECT OUR OPERATIONS.

An accident in our facilities could occur. Any accident, whether due to the production of our batteries or otherwise resulting from our facilities' operations, could result in significant manufacturing delays or claims for damages resulting from personal or property injuries, which would adversely affect our operations and financial condition.

WE DEPEND UPON THE CONTINUED OPERATION OF OUR NORTHERN IRELAND FACILITY.

OPERATIONAL PROBLEMS AT THIS FACILITY COULD HARM OUR BUSINESS.

Our revenues are dependent upon the continued operation of our manufacturing facility in Northern Ireland. The operation of a manufacturing plant involves many risks, including potential damage from fire or natural disasters. In addition, we have obtained permits to conduct our business as currently operated at the facility. If the facility were destroyed and rebuilt there is a possibility that these permits would not remain effective at the current location, and we may not be able to obtain similar permits to operate at another location. The occurrence of these or any other operational problems at our Northern Ireland facility may harm our business.

WE EXPECT TO SELL A SIGNIFICANT PORTION OF OUR PRODUCTS TO AND DERIVE A

SIGNIFICANT PORTION OF OUR LICENSING REVENUES FROM CUSTOMERS LOCATED OUTSIDE THE

UNITED STATES. FOREIGN GOVERNMENT REGULATIONS, CURRENCY FLUCTUATIONS AND

INCREASED COSTS ASSOCIATED WITH INTERNATIONAL SALES COULD MAKE OUR PRODUCTS AND

LICENSES UNAFFORDABLE IN FOREIGN MARKETS, WHICH WOULD REDUCE OUR FUTURE

PROFITABILITY.

We expect that international sales of our products and licenses, as well as licensing royalties will represent an increasingly significant portion of our sales. International business can be subject to many inherent risks that are difficult or impossible for us to predict or control, including:

o changes in foreign government regulations and technical standards, including additional regulation of rechargeable batteries or technology or the transport of lithium and phosphate, which may reduce or eliminate our ability to sell or license in certain markets;

o foreign governments may impose tariffs, quotas and taxes on our batteries or our import of technology into their countries;

o requirements or preferences of foreign nations for domestic products could reduce demand for our batteries and our technology;

o fluctuations in currency exchange rates relative to the United States dollar could make our batteries and our technology unaffordable to foreign purchasers and licensees or more expensive compared to those of foreign manufacturers and licensors;

o longer payment cycles typically associated with international sales and potential difficulties in collecting accounts receivable may reduce the future profitability of foreign sales and royalties;

o import and export licensing requirements in Northern Ireland or other countries where we intend to conduct business may reduce or eliminate our ability to sell or license in certain markets; and

o political and economic instability in Northern Ireland or other countries where we intend to conduct business may reduce the demand for our batteries and our technology or our ability to market our batteries and our technology in those countries.

These risks may increase our costs of doing business internationally and reduce our sales and royalties or future profitability.

WE MUST CONTINUE TO EXPAND OUR EMPLOYEE BASE AND OPERATIONS IN ORDER TO DISTRIBUTE OUR PRODUCTS COMMERCIALLY, WHICH MAY STRAIN OUR MANAGEMENT AND RESOURCES AND COULD HARM OUR BUSINESS.

To implement our growth strategy successfully, we will have to increase our staff, primarily with personnel in sales, marketing, and product support capabilities, as well as third party and direct distribution channels. However, we face the risk that we may not be able to attract new employees to sufficiently increase our staff or product support capabilities, or that we will not be successful in our sales and marketing efforts. Failure in any of these areas could impair our ability to execute our plans for growth and adversely affect our future profitability.

COMPETITION FOR PERSONNEL, IN PARTICULAR FOR PRODUCT DEVELOPMENT AND PRODUCT IMPLEMENTATION PERSONNEL, IS INTENSE, AND WE MAY HAVE DIFFICULTY ATTRACTING THE PERSONNEL NECESSARY TO EFFECTIVELY OPERATE OUR BUSINESS.

We believe that our future success will depend in large part on our ability to attract and retain highly skilled technical, managerial and marketing personnel who are familiar with and experienced in the battery industry, as well as skilled personnel to operate our facility in Northern Ireland. If we cannot attract and retain experienced sales and marketing executives, we may not achieve the visibility in the marketplace that we need to obtain purchase orders, which would have the result of lowering our sales and earnings. We compete in the market for personnel against numerous companies, including larger, more established competitors with significantly greater financial resources than us. We cannot be certain that we will be successful in attracting and retaining the skilled personnel necessary to operate our business effectively in the future.

THE LIMITED NUMBER OF SKILLED WORKERS IN NORTHERN IRELAND COULD AFFECT THE SUCCESS OF OUR IMPROVEMENTS IN THE MANUFACTURING FACILITY.

We may need to hire and train additional manufacturing workers. The availability of skilled workers in Northern Ireland is limited because of a relatively low unemployment rate. As a result, we face the risk that we may not:

o hire and train the new manufacturing workers necessary for the ramp-up of our Mallusk, Northern Ireland manufacturing facility;

o develop improved processes;

o implement multiple production lines; or

o efficiently operate the Mallusk facility.

Our failure to efficiently automate our production on a timely basis, if at all, could damage our reputation, relationships with future and existing customers, cause us to lose business and potentially prevent us from establishing the commercial viability of our products.

POLITICAL INSTABILITY IN NORTHERN IRELAND COULD INTERRUPT MANUFACTURING OF OUR

BATTERIES AND END-USER PRODUCTS AT OUR NORTHERN IRELAND FACILITY AND CAUSE US TO

LOSE SALES AND MARKETING OPPORTUNITIES.

Northern Ireland has experienced significant social and political unrest in the past and we cannot assure you that these instabilities will not continue in the future. Any political instability in Northern Ireland could temporarily or permanently interrupt our manufacturing of batteries and end-user products at our facility in Mallusk, Northern Ireland. Any delays could also cause us to lose sales and marketing opportunities, as potential customers would find other vendors to meet their needs.

RISKS ASSOCIATED W ITH OUR INDUSTRY

IF COMPETING TECHNOLOGIES THAT OUTPERFORM OUR BATTERIES WERE DEVELOPED AND

SUCCESSFULLY INTRODUCED, THEN OUR PRODUCTS MIGHT NOT BE ABLE TO COMPETE

EFFECTIVELY IN OUR TARGETED MARKET SEGMENTS.

Rapid and ongoing changes in technology and product standards could quickly render our products less competitive, or even obsolete. Other companies are seeking to enhance traditional battery technologies, such as lead acid and nickel cadmium or have recently introduced or are developing batteries based on nickel metal-hydride, liquid lithium-ion and other emerging and potential technologies. These competitors are engaged in significant development work on these various battery systems, and we believe that much of this effort is focused on achieving higher energy densities for low power applications such as portable electronics. One or more new, higher energy rechargeable battery technologies could be introduced which could be directly competitive with, or superior to, our technology. The capabilities of many of these competing technologies have improved over the past several years. Competing technologies that outperform our batteries could be developed and successfully introduced, and as a result, there is a risk that our products may not be able to compete effectively in our targeted market segments.

We have invested in research and development of next-generation technology in energy solutions. If we are not successful in developing and commercially exploiting new energy solutions based on new materials, or we experience delays in the development and exploitation of new energy solutions, compared to our competitors, our future growth and revenues will be adversely affected.

OUR PRINCIPAL COMPETITORS HAVE GREATER FINANCIAL AND MARKETING RESOURCES

THAN WE

DO AND THEY MAY THEREFORE DEVELOP BATTERIES SIMILAR OR SUPERIOR TO OURS OR

OTHERWISE COMPETE MORE SUCCESSFULLY THAN WE DO.

Competition in the rechargeable battery industry is intense. The industry consists of major domestic and international companies, most of which have financial, technical, marketing, sales, manufacturing, distribution and other resources substantially greater than ours. There is a risk that other companies may develop batteries similar or superior to ours. In addition, many of these companies have name recognition, established positions in the market, and long standing relationships with original equipment manufacturers and other customers. We believe that our primary competitors are existing suppliers of liquid lithium-ion, competing polymer and, in some cases, nickel metal-hydride batteries. These suppliers include Sanyo, Matsushita Industrial Co., Ltd. (Panasonic), Sony, Toshiba, SAFT and Electrovaya. All of these companies are very large and have substantial resources and market presence. We expect that we will compete against manufacturers of other types of batteries in our targeted application segments, which include laptops, cellular telephones and personal digital assistant products, on the basis of performance, size and shape, cost and ease of recycling. There is also a risk that we may not be able to compete successfully against manufacturers of other types of batteries in any of our targeted applications.

LAWS REGULATING THE MANUFACTURE OR TRANSPORT OF BATTERIES MAY BE ENACTED WHICH

COULD RESULT IN A DELAY IN THE PRODUCTION OF OUR BATTERIES OR THE IMPOSITION OF

ADDITIONAL COSTS THAT WOULD HARM OUR ABILITY TO BE PROFITABLE.

At the present time, international, federal, state or local law does not directly regulate the storage, use and disposal of the component parts of our batteries or the transport of our batteries. However, laws and regulations may be enacted in the future which could impose environmental, health and safety controls on the storage, use, and disposal of certain chemicals and metals used in the manufacture of lithium polymer batteries as well as regulations governing the transport of our batteries. Satisfying any future laws or regulations could require significant time and

resources from our technical staff and possible redesign which may result in substantial expenditures and delays in the production of our product, all of which could harm our business and reduce our future profitability.

GENERAL RISKS ASSOCIATE D WITH STOCK OWNERSHIP

CORPORATE INSIDERS OR THEIR AFFILIATES WILL BE ABLE TO EXERCISE SIGNIFICANT

CONTROL OVER MATTERS REQUIRING STOCKHOLDER APPROVAL THAT MIGHT NOT BE IN THE

BEST INTERESTS OF OUR STOCKHOLDERS AS A WHOLE.

As of June 21, 2002, our officers, directors, and their affiliates as a group beneficially owned approximately 12.1% of our outstanding common stock. Carl Berg, one of our directors, owns a substantial portion of that amount. As a result, these stockholders will be able to exercise significant control over all matters requiring stockholder approval, including the election of directors and the approval of significant corporate transactions, which could delay or prevent someone from acquiring or merging with us. The interest of our officers and directors, when acting in their capacity as

stockholders, may lead them to:

o vote for the election of directors who agree with the incumbent officers' or directors' preferred corporate policy; or

o oppose or support significant corporate transactions when these transactions further their interests as incumbent officers or directors, even if these interests diverge from their interests as shareholders per se and thus from the interests of other shareholders.

SOME PROVISIONS OF OUR CHARTER DOCUMENTS MAY MAKE TAKEOVER ATTEMPTS DIFFICULT,

WHICH COULD DEPRESS THE PRICE OF OUR STOCK AND LIMIT THE PRICE POTENTIAL

ACQUIRERS MAY BE WILLING TO PAY FOR YOUR SHARES.

Our board of directors has the authority, without any action by the stockholders, to issue additional shares of our preferred stock, which shares may be given superior voting, liquidation, distribution and other rights as compared to those of our common stock. The rights of the holders of our capital stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of additional shares of preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. These provisions may have the effect of delaying, deferring or preventing a change in control, may discourage bids for our common stock at a premium over its market price and may decrease the market price, and infringe upon the voting and other rights of the holders, of our common stock.

OUR STOCK PRICE IS VOLATILE.

The market price of the shares of our common stock has been and is likely to continue to be highly volatile. Factors that may have a significant effect on the market price of our common stock include the following:

o fluctuation in our operating results;

o announcements of technological innovations or new commercial products by us or our competitors;

o failure to achieve operating results projected by securities analysts;

o governmental regulation;

o developments in our patent or other proprietary rights or our competitors' developments;

o our relationships with current or future collaborative partners; and

o other factors and events beyond our control.

In addition, the stock market in general has experienced extreme volatility that often has been unrelated to the operating performance of particular companies. These broad market and industry fluctuations may adversely affect the trading price of our common stock, regardless of our actual operating performance.

As a result of this potential stock price volatility, investors may be unable to sell their shares of our common stock at or

above the cost of their purchase prices. In addition, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation. If we were the subject of securities class action litigation, this could result in substantial costs, a diversion of our management's attention and resources and harm to our business and financial condition.

FUTURE SALES OF CURRENTLY OUTSTANDING SHARES COULD ADVERSELY AFFECT OUR STOCK

PRICE.

The market price of our common stock could drop as a result of sales of a large number of shares in the market or in response to the perception that these sales could occur. In addition these sales might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. We had outstanding 51,692,144 shares of common stock as of June 21, 2002. In addition, at June 21, 2002, we had 5,461,629 shares of our common stock reserved for issuance under outstanding options and warrants, and 12,066,000 additional shares reserved for issuance under our stock option plans.

SALES OF SHARES ELIGIBLE FOR FUTURE SALE COULD IMPAIR OUR STOCK PRICE.

Sales of a substantial number of shares of common stock in the public market, or the perception that sales could occur, could adversely affect the market price for our common stock. This offering will result in additional shares of our common stock being available on the public market. These factors could also make it more difficult to raise funds through future offerings of common stock.

WE DO NOT INTEND TO PAY DIVIDENDS AND THEREFORE YOU WILL ONLY BE ABLE TO RECOVER

YOUR INVESTMENT IN OUR COMMON STOCK, IF AT ALL, BY SELLING THE SHARES OF OUR

STOCK THAT YOU HOLD.

Some investors favor companies that pay dividends. We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth and we do not anticipate paying cash dividends on our common stock in the foreseeable future. Because we may not pay dividends, your return on an investment in our stock likely depends on your ability to sell your shares at a profit.
